HELP ?

Fixing what really ails Japan

Foreign Affairs; New York; May/Jun 1999; Michael E Porter; Hirotaka Takeuchi;

Volume: 78
Issue: 3
Start Page: 66
ISSN: 00157120
Full Text:

CONVENTIONAL WISDOM

NOT so long ago, the entire world stood in awe of Japan's postwar economic miracle. Some Japanese policymakers boasted that they had invented a new and superior form of capitalism. But today, Japan is stuck in the slump that just will not quit. In policy circles there is talk of a defeat, this time at the hands of Anglo-Saxon capitalism. Yet despite the depth and the persistence of the slide, remarkably few question Japan's underlying economic model. Everyone agrees that some reforms are needed but assumes that the economic engine is basically sound, if only the government would jump-start it with a massive kick of credit. Only recently, confronted with company failures and huge losses, have most Japanese begun to realize the magnitude of their problem.

The prevailing consensus over Japan's failings in the 1990s centers around three related explanations. One is the collapse of the so-called bubble economy of overvalued equities and real estate. Imploding asset prices have sent ripples through the banking system, making credit scarce. A second explanation argues that Japan is overregulated by meddlesome government ministries. The third claims that bureaucrats have mismanaged macroeconomic policy by raising taxes, failing to stimulate internal demand, and clinging to export-led growth for too long.

Stimulating the economy and restoring the flow of capital are necessary. But quick fixes and macroeconomic adjustments will not do enough. What ails Japan runs deeper, has been brewing for decades, and is rooted in the microeconomics of how Japan competes. Our research challenges the conventional wisdom about Japan's unparalleled rise in competitiveness. Since the 198os, this stream of scholarship has offered two related explanations for Japan's meteoric rise: one points to a set of government policies, the second to a set of common corporate management techniques. Both explanations have been widely accepted and have had a profound impact on the rest of the world. Policymakers and business leaders in other countries have tried to clone the Japanese model or to borrow its parts. In Japan and elsewhere, it has been appealing for a variety of political and cultural reasons to believe that Japan had invented a new and intrinsically superior form of capitalism, one more controlled and egalitarian than the Anglo-Saxon version.

This simply is not the case. The much-celebrated government model is wrong; in fact, it explains Japan's failures more than its successes. The model of corporate success has merit but is dangerously incomplete. There is much that works in Japan, but in order to build on it leaders must understand the real roots of their successes and failures. The problem starts with the government's mistrust of competition, which often makes it intervene in the economy in ways that harm the nation's productivity and prosperity. Companies, for their part, take the wrong approach to competition and thus undermine their own profitability. Fixing what really ails Japan, therefore, will require fundamental changes in both government and corporate practices.

The consensus over Japan's past success has come overwhelmingly from the robust growth of a relatively small number of industries. Observers looked at these cases, described what happened, and then made the intellectual leap to generalize about the entire country's success. The same industries-semiconductors, machine tools, and steel-were examined over and over again (it is notable that these sectors look far less robust today). Another problem is that some of the most influential accounts of Japan's "miracle" were written by Western scholars whose primary interest was in the workings of government. It was therefore natural that they noted unusual government policies and then concluded that those explained business growth. Finally, students of business competition and management focused on unique Japanese practices such as kanban (just-in-time delivery) and total quality management and emphasized them when explaining market success.

These factors led to an incomplete understanding of Japanese industry. Prescriptions for Japan should be based on understanding not just its successes but also its failures. The reality is that Japan has always had many uncompetitive industries, with virtually no share of international markets. These have rarely been given much attention-but it is only by examining such failures that it is possible to distinguish between good and bad policies. In addition, to understand why many Japanese industries remain globally competitive in the midst of today's recession, it is necessary to go beyond the commonly studied success cases. Our research therefore included i8 major industries representing all important parts of the Japanese economy and whose success dates from the 19q.os to the1990 We supplemented these case studies with statistical analyses covering the entire economy.

THE GOVERNMENT MODEL

THE UNDERLYING rationale for the Japanese government's activist role is that no corporation can have the proper perspective and information to guide the economy. Some industries should be targeted because their growth prospects and opportunities to support a higher standard of living are inherently better than others; other industries should be sheltered to gain scale to compete internationally. Intervention in general avoids the wasteful and destructive aspects of competition and allows a country to conserve its resources. At the center of this thinking lies an export-led growth policy promoted by the central government and guided by a stable bureaucracy, with governmentsponsored cooperative research and development (R&D), lax antitrust policies, officially sanctioned cartels, subsidized activities, and intervention in declining industries. Restrictions on trade and foreign investment, which have been reduced only grudgingly, also fit this view, since they allow Japanese companies to gain strength at home in order to penetrate markets abroad.

The Japanese government model was derived from actual practices found in oft-studied successful industries: household sewing machines (1950s), steel (1960s), shipbuilding (1970s), and semiconductors (1980s). But a much wider sample revealed that these cases were not representative. In fact, each decade also gave rise to internationally competitive industries where virtually none of the practices of the government model were employed: motorcycles (1960s), audio equipment (1970s), automobiles (1980s), and game software (1990s). We studied these and more than a dozen other successful industries extensively, ranging from robotics, sewing machines, fax machines, and home air conditioners to carbon fiber and soy sauce. Government intervention was again almost entirely absent. There were no major subsidies and little or no intervention in the competitive process. One partial exception was sewing machines, which had been targeted right after World War II to meet domestic demand for clothing and employment. But Japan became competitive not in household but in industrial sewing machines, where government intervention was largely absent.

A deeper look at these successful industries found that the government was indeed involved after all-but in a variety of unexpected roles. Through a slew of initiatives, the government stimulated early demand for new products and fostered the competitiveness of certain industries. In fax machines, for example, Nippon Telegraph and Telephone Corporation (NTT), then the Japanese government telephone company, heavily promoted office use of fax technology and adopted it in government agencies early on. The government quickly agreed to global standards to ensure that all fax machines were compatible. The Ministry of International Trade and Industry (MITI) encouraged companies to buy more-expensive models. In the early 1980s, the government sanctioned fax documents as legal for many purposes. All of these practices helped build early demand for sophisticated machines and spurred Japanese companies to invest in the industry and improve their products. A similar story could be told for robotics, where a leasing system encouraged robot use among small and medium-sized companies.

In other cases, stringent government standards triggered innovation. In home air conditioners, for example, the Japanese Energy Conservation Law (1979) led to a flurry of efforts to reduce energy use and to the invention of the rotary compressor, a fundamental technological breakthrough that reduced power consumption. To these roles can be added two other Japanese government practices not part of the traditional model-policies that encouraged a high savings rate and rigorous basic education. In these modern success stories, the government played a variety of roles but intervened in competition very little. In some cases, such as automobiles, the industry actually spurned the government's efforts to suppress rivalry.

It is the failures, however, that make the strongest argument against the government model. Our sample covered a wide swath of important sectors of the economy, including consumer goods (apparel and detergents), advanced manufacturing (civil aircraft and chemicals), services (financial services and computer software), and prepared foods (chocolate). Particular industries were sometimes chosen to offer a window into a broader sector Chocolate typifies the uncompetitive prepared-food sector, where Japan is internationally successful in just one product, soy sauce, and somewhat successful in another (instant noodles). Similarly, detergents revealed a set of problems common to consumer packaged goods, where Japan has had virtually no international success.

What became clear is that policies at the core of the government model were prominent in the failure industries. In civil aircraft, for example, the industry was essentially a single consortium. All the aircraft and engine development projects were cooperative and there was virtually no competition among the companies. In chemicals, a MITI-targeted sector, the government provided price controls, favorable tax incentives, loans, approvals of new entrants, cartels to coordinate the reduction of excess capacity, and subsidized R&D. Fixed prices, limits on competition, protection from foreign competitors, and government-supported loans to the industry characterized the securities market. The computer software industry enjoyed cooperative research, joint projects, subsidies, and loan guarantees. A similar array of policies was found in other failure industries. In fact, the practices widely believed to explain Japan's success were far more prevalent and pervasive in its failures.

In the unsuccessful industries, we also discerned unexpected problems. One was a shortage of trained talent. Japan is often praised-and rightly so-for its rigorous basic education and its large pool of well-trained engineers. But Japanese universities are weak in a number of fields important to the poorly performing industries, such as chemistry and chemical engineering, software and aeronautical engineering, and finance. Another unexpected problem was that inefficiencies in domestic retailing, wholesaling, agriculture, and logistics exacted a heavy toll: higher costs, incompatibility with foreign markets, and weakened competitiveness of many export industries.

Conventional wisdom also proved faulty about two core practices of the Japanese government: legal cartels and cooperative R&D. Data on the 1,379 registered cartels between 1973 and 1990 showed that cartels were far more prevalent in the failure industries than in the successes. Indeed, cartels were and are extraordinarily rare in Japan's internationally competitive industries. Where they do exist, they are most likely export cartels, or groupings in competitive industries that allow government to respond to trade friction by slowing exports. The data on the 237 government-sponsored R&D consortia from 1959 to 1992 also failed to support the government model, as they were equally distributed in successful and unsuccessful industries. Many cooperative R&D projects were outright failures.

Our studies thus conclude that the government model played little if any role in the successful industries, with scarcely any intervention, few cartels, and scant cooperative R&D. Among the failures, the government model prevailed, with numerous cartels, widespread cooperation, and rampant intervention in competition. If anything, the Japanese government model is a cause of failure, not of success.

THE CORPORATE MODEL

THE MODEL of Japanese corporate success centers on the notion that a company can achieve both high quality and low cost by employing-and continuously improving-fundamentally better managerial practices. The idea is that companies compete by relentlessly staying at the frontier of best practice. This model is not an abstract theory but stems from extraordinary advances made by Japanese companies after the introduction of now well-known managerial practices, such as total quality management (TOM), lean production, and close supplier relationships. The model clearly worked through the 1980s, producing results so stunning that at first many Western companies believed that the Japanese were competing unfairly by pricing below cost. In fact, Japanese companies were just incredibly productive. Exports grew rapidly as Japanese companies seized world market share in many industries. And since productivity was rising so dramatically, Japanese wages and per capita income grew rapidly as well.

Even before the real-estate and stock-market bubble burst, however, signs of weakness had emerged. First, a large number of Japanese industries were simply not competitive; many were downright unproductive and a drag on the economy's overall productivity. One result was an extraordinarily high cost of living. The Japanese paid (and still pay) too much for almost everything, forcing their standard of living far lower than their per capita income suggests. Second, the array of significant export industries was remarkably small for a large economy. Japan's top 50 industries' export value accounted for 59 percent of Japanese exports in 1993, compared to 46 percent in Sweden, 43 percent in the United States, and 38 percent in Germany. Japan is comparable to Canada and Korea in export concentration, with exports dominated by a relatively small number of industries in automotives, consumer electronics, office machines, and production machinery. In huge areas of the economy there are few if any successful exporters, including chemicals, packaged goods, services, and health care. Third, Japanese corporate profit rates were chronically low by international standards (even in the successful industries before the bubble burst). Fourth, by the late 198os growth had slowed and export share peaked. In some industries it was actually declining. Finally, the Japanese corporate model did not give rise to a next generation of dynamic export industries, a striking sign that something was fundamentally amiss.

How can Japan's apparent competitive success be reconciled with its low profitability, limited array of competitive industries, and inability to sustain competitiveness? The answer rests on two distinct

approaches to competition: operational effectiveness and strategy. The Japanese set the world standard in the 1970s and 1980s for the former-that is, for improving quality and lowering cost. Japanese companies literally taught the world many management approaches that are enormously useful to nearly any company in any industry. They were so far ahead in this dimension that they defined the frontier of productivity. Much more operationally effective than Western companies, they could beat them on both cost and differentiation. In the successful industries, Japanese companies also competed fiercely with each other, rapidly matching each other's moves and driving operational improvement even faster. It also meant that even in industries where rivals started out with distinct competitive positions-as was the case in fax machines-they eventually converged.

Initially there was room for everybody to grow. Although one Japanese company could rarely stay ahead of the others, as a group they gained international market share. But today, the rest of the world has caught up and some are leapfrogging ahead, particularly American companies that have been more aggressive about restructuring and using information technology. Japan's relative weaknesses are especially evident in activities outside of production, such as planning and control, finance, logistics, distribution, order processing, customer information, and after-sale service. The problem is that if all companies offer more or less the same value, customers must choose between them solely based on cost, inevitably undermining prices and profitability. The many Japanese companies that compete on operational effectiveness alone have thus been caught in a trap of their own making. Having lost their decisive lead in operational effectiveness, these companies found that competitive convergence and slower growth have made the 199os extraordinarily painful.

Operational effectiveness, however, is just one of two ways a company can achieve superior performance. The other is through strategy-competing on the basis of a unique product or service. Strategy requires a company to make choices about how it will deliver value to its customers. Strategy and operational effectiveness are complementary, not antithetical, but both are necessary for sustained and superior performance. Although Japanese companies excel at the continuous incremental improvement required to compete on operations, most are not distinguished by broad, innovative strategy.

There are some notable exceptions. A handful of the most celebrated and successful companies in Japan do have clear strategies, but this is not widely appreciated as what sets them apart. Honda did not win because it was better at kanban or TQM or because it copied Toyota. It won because its distinctive strategy produced unique vehicles and unique marketing. The same is true for Sony in consumer electronics and for Nintendo and Sega in video games. But it is telling that these immensely successful companies are seen in Japan as mavericks.

COMPETITION IS CRUCIAL

THE GOVERNMENT policies that are widely believed to explain Japan's success-practices that limit competition in myriad waysturn out to have inflicted a profound cost on the Japanese economy. Those industries that prospered did so in spite of these policies, not because of them. This finding is consistent with what is known about the competitiveness of other countries-vigorous rivalry is the only path to economic vitality. Ultimately, a country's productivity is the sum of its corporate productivity. As a measure that includes both the prices that products and services can command and the efficiency with which they are produced, productivity reflects the sophistication with which companies compete.

It is here that public policy and private business practice intersect. Macroeconomic policy sets the broad context but does not itself create wealth. It is the microeconomic environment, also shaped by public

policy, that strongly influences competitive sophistication, efficiency, and the types of feasible strategies. Companies will have a hard time competing on the basis of differentiated products and superior service if they cannot find well-educated staff, if marketing channels are poorly developed, or if local customers are unsophisticated. In every one of our case studies, microeconomic environment and company performance were inextricably intertwined. Japanese companies were only competitive to the extent that their business environments were dynamic, stimulating, and intensely competitive. And in industry after industry, the business environment was shaped by four interrelated influences.

The first is the cost, quality, and specialization of fundamental inputs, such as skilled employees or basic raw materials. Companies must be able to acquire these at a competitive price and quality. Although the most basic factor inputs rarely constitute a competitive advantage because many locations have them or they can be accessed in global markets-they can contribute to competitive disadvantage. Japan's failure industries were typically plagued by such handicaps. Consider chocolates, where government trade barriers meant that Japanese companies paid excessive prices for imported sugar and cocoa. In contrast, the internationally competitive soy sauce industry had no import restraints. Competitive advantages normally arise from pools of specialized inputs. Japan's supply of highly trained electrical and mechanical engineers, for example, has clearly given it an edge in fax machines, robotics, and consumer electronics. Conversely, Japan's weak chemical sector has long suffered from a shortage of chemists and chemical engineers, a problem related to weaknesses in research and in the university system.

The second influence on business environments is especially critical in advanced competition: efficient local access to the most advanced and specialized suppliers and partners. When interconnected companies and institutions cluster in one location-Silicon Valley, for example all companies gain from the proximity of specialized components, services, and know-how, which enables them to improve productivity and pursue more sophisticated strategies. Japan's successful industries almost always could be found to have benefited from such a cluster. Consider robotics: it is no accident that Japan has also been a world leader in a host of related and supporting industries-numerical controls, machine tools, optical sensors, and motors. In home air conditioners, Japan leads the way in components such as converters, compressors, small motors, and radiators. Similarly, Japan's fax industry grew out of a powerful cluster in cameras, optics, and electronics.

The third influence is the sophistication of local customers. When consumers are knowledgeable and demanding, companies must work harder to provide satisfaction. Strong quality, safety, health, and environmental standards often enhance customer sophistication and push companies to use more advanced technologies. In robotics, for example, Japanese manufacturers moved to large-scale robot use much faster than companies in other countries because of their sophisticated manufacturing practice, shortage of skilled workers, and caution in hiring due to lifetime employment. In the fax machine market, the problems posed by the Japanese language for typewriters and telex machines, office space constraints, major time differences with large foreign markets, and expensive telephone charges all meant producers had to meet stringent local needs.

The contrast between air conditioners and detergents is also instructive. Japan is a nation of small, closely packed houses and hot, muggy summers-hence a strong local demand for compact, quiet air conditioners. Over time, knowledgeable consumers have pushed manufacturers to upgrade their products' performance and add features. Following the oil crisis of the 197os, the government set stringent energy standards that triggered additional innovation. In detergents, on the other hand, the Japanese market is so different from the rest of the world that home demand distracts Japanese companies from becoming globally competitive. The same energy and space constraints that led to successful air conditioners resulted in small washing machines and frequent loads. This, coupled with

softer water, produced detergents of lower quality than those required by foreign customers.

The most powerful of the four influences shaping a business environment, however, is intense local rivalry. It drives innovation and continued improvement in productivity. The nature of such rivalry is governed by policies, incentives, and norms that directly affect competition (such as trade, foreign investment, and antitrust policy) or that affect the climate for investment and competition (such as the tax system, the corporate governance system, labor market policies, and intellectual property rights).

In virtually all the Japanese failure cases, rivalry was constrained in some way, often by government-imposed impediments. In chemicals, for example, the government controlled production levels. In securities, overregulation by the government and fixed commissions created a comfortable oligopoly of just four (now three) players. In detergents, the government protected the home industry from foreign competition, effectively leaving two companies in control of the market. In contrast, vigorous local competition occurred in all of Japan's internationally successful industries. In air conditioners, more than a dozen rivals competed aggressively with each other, while there were well over 100 robotics companies and more than 15 fax-machine producers. These findings were confirmed statistically. In a broad sample of Japanese industries, the intensity of local rivalry as measured by market-share fluctuation was by far the dominant factor explaining international success. This link was one of the most striking research findings. Although some Japanese say this rivalry is excessive, that is only because of flaws in the Japanese approach to competition, such as a lack of focus on profitability and pervasive imitation.

FREEING THE INVISIBLE HAND

PIECEMEAL SOLUTIONS and quick fixes-bailing out financial institutions, lowering consumption taxes, issuing merchandise voucherswill not solve Japan's economic ills because of these deeper, underlying problems. Japan must speed up the pace of regulatory reform and increase the transparency of the regulatory process. But it is overly simplistic to label all regulations bad-those that stimulate early demand for new products foster competitiveness, and high standards in energy usage, safety, quality, and noise encourage innovation. Instead, the single biggest lesson from Japan's failures is that the government should abandon its anticompetitive policies. Japanese policymakers need to rethink lax antitrust policy, rampant cartels and consortia, government guidance, and regulatory barriers to competition. Enhancing competition, not just deregulation per se, must be the goal of regulatory reform. The same holds true for trade. It is time for Japan to confidently embrace free trade, which will reduce input costs and increase competitiveness across all industries. Restraining imports actually crippled many of the industries it was designed to protect and dragged down others.

Responsibility for many of Japan's uncompetitive industries can be traced back to the universities. University and graduate training is uneven in quality. Japanese universities fail to produce enough students in important disciplines like computer software and biotechnology, and also fail in their research. Hampered by scarce funds and antiquated facilities, these schools lack strong research programs in many important fields and focus on applied work rather than original science. With promotion based on seniority, the incentive to conduct innovative work in new fields is minimal. The core of Japanese research resides in companies and to a far lesser extent government laboratories. But unfettered university-based research is critical to competition. It is more open than private or government research, training advanced scientists and engineers and providing a fertile breeding ground for new companies. Lacking this component, Japan has compensated with distorting subsidies to individual companies and cumbersome government-sponsored cooperative R&D.

Many of Japan's failures can also be traced to fragmented, inefficient, and anachronistic domestic sectors such as retailing, wholesaling, logistics, financial services, health care, energy, trucking, telecommunications, housing, and agriculture. By design, government policies have created two Japans: one composed of highly productive export industries, the other containing domestic sectors. Inefficiency in the latter set was all but guaranteed by a huge array of rules and policies that raised costs, barred competition, and limited consolidation. The government hoped that while the efficient Japan would carry the economy, the inefficient Japan would provide stability, jobs, selfsufficiency, and an implicit retirement system of small family businesses. The obvious price of this solution was borne by Japanese consumers. Policymakers, however, failed to anticipate two devastating consequences of this approach. First, the inefficient Japan drives up business costs across the board, weakening the competitiveness of the export industries. Second, it inhibits the formation of internationally competitive industries in huge parts of the economy. Japanese domestic industries are so idiosyncratic that their operating practices do not work in foreign markets. Japan's distorted service sector, in a world where services are increasingly traded, precludes competitiveness in those areas in which an advanced country should be growing. The net result is an almost total absence of new Japanese export industries.

A new corporate governance system-one less beholden to banks and bureaucrats-is needed to enhance accountability. Without pressure to use capital efficiently and earn decent profits, Japanese companies will not address their fundamental competitiveness problems. Shareholders need more influence, boards of directors more independence, and corporate decisions and financial results must be made more transparent. Japan must also move from a financing system based on collateralized loans and guarantees toward one that encourages risk. In the process, though, Japan should preserve its longer investment horizons and not adopt the frenzied trading of the Anglo-Saxon system.

Lastly, the Japanese government tends to centralize economic activity around Tokyo and Osaka, a practice that not only creates congestion and high costs but also impedes the formation of healthy business clusters. In California, for example, which is approximately the size of Japan, vibrant clusters of microelectronics and biotechnology flourish in Silicon Valley, multimedia in San Francisco; and entertainment, defense, and aerospace in Los Angeles. By promoting decentralization and specialization, the Japanese government will fuel productivity and innovation.

PRIORITIES FOR BUSINESS

DESPITE THE persistent problems of the 199os, Japanese business executives have yet to fundamentally question how they compete. In response to poor profitability, Japanese companies have migrated offshore in search of cheap labor and other inexpensive inputs-a continuation of operational thinking-rather than change their way of competing. In response to slow growth, companies have diversified into unrelated businesses instead of fixing the problems in their core. Improvements in operational effectiveness must continue but must widen to encompass office productivity, information technology, the Internet, marketing, and other traditionally weak areas. Japan must catch up in computer technology and information networking in schools, homes, and offices.

Japanese companies must embrace strategy that forsakes imitation and distinguishes them from rivals. Strategy depends on tradeoffs, but the Japanese have gotten so used to competing by extending the productivity frontier-pursuing both cost and quality advantages equally-that they fail to decide where on the frontier to compete. The importance of consensus in decision-making and the deeply ingrained tradition of customer service exacerbate this tendency. Japanese executives treat every customer need as equally valid-trying to be all things to all people. They rarely choose which customers to serve and

which to leave to competitors. Companies must understand that the essence of strategy is choosing what not to do.

These companies need not look far to discover that companies with distinctive strategies are winning in the global market. In video games, Nintendo, Sega, and Sony have chosen to do different things and achieved success as a result. Nintendo emphasized speed and playability, Sega offered enhanced graphics, and Sony focused on low cost.

A pervasive weakness in the Japanese approach to competition is the tendency to ignore industry structure--such as the power of customers and the availability of substitute products-in deciding both where and how to compete. Profitability depends not only on a company's own position but on the structure of the industry itself Japanese companies enter "high-tech" or growing industries assuming they will be attractive-but without studying industry economics. Thus they end up crowding into unprofitable industries or undermining industry structure (such as by transferring power to customers), and then wondering why the profits are poor or nonexistent.

Japanese companies should abandon the outmoded dream of becoming diversified giants like Toshiba, Hitachi, or Mitsubishi Electric, who make everything from microchips and batteries to power plants and automated assembly plants. Contrast these companies, now facing their worst crises in history, with high performers, all of whom had focused strategies. They include Advantest, one of the world's top manufacturers of chip-testing equipment; Futaba Corporation, with 8o percent of the world market in fluorescent indicator tubes; Kyoden Company, a leader in Japan's market for printed circuit boards; and Nidec Corporation, which dominates specialized motors.

Profitability is the only reliable measure of sound strategy. Lifetime employment and lack of shareholder pressure have led Japanese companies to put growth ahead of profitability, but they are starting to realize that this drives imitation, competitive convergence, unrelated diversification, and massive excess capacity. Shifting their goal now will require some fundamental changes in Japanese businesses, but concern with profits is growing, partly due to pressure from non-Japanese investors. Embracing strategy will inevitably challenge the dominant Japanese model of leadership and organization. Leaders in Japan most often see their role as building consensus, ensuring continuity, and providing for orderly succession. But what Japan needs today are leaders like Sony's Nobuyuki Idei, Orix's Yoshihiko Miyauchi, and Softbank's Masayoshi Son. Seen as mavericks in Japan, they are not afraid to rock the boat and make bold moves. They exemplify the new type of innovative thinkers and risk-takers who are emerging in Japan.

Japan's dominant organizational structure is still designed to foster continuous and incremental improvement. Central control at the corporate level is overbearing. Reorganizations similar to the one Idei is implementing at Sony are also in order. He restructured the company to enhance autonomy, foster innovation, speed up decision-making, and improve accountability. Japanese companies can also take steps to improve governance. Sony's recent move to cut its board to lo from 38 and include 3 outside directors is one that many companies should take. Finally, Japanese companies will continue to suffer from imitation and indistinct strategies until internal incentives are modified. Currently they encourage imitation, which is taken as demonstrating that a manager is careful and has diligently studied competitors. The Japanese system penalizes mistakes but does not reward successes, creating strong pressures to follow competitors. Companies must move from an exclusively egalitarian, seniority-driven model to one where doing things differently is rewarded in compensation, advancement, and opportunities for entrepreneurship.

CAN JAPAN CHANGE?

JAPAN'S LEADERS are proud of their hard-won economic growth and remain wary of Anglo-Saxon capitalism. But many have drawn the wrong lessons from their success-a lack of objectivity that has been reinforced by international opinion. Although Japan is a nation that reveres its traditions, it is also a country that has demonstrated an extraordinary capacity to transform itself when the common well-being is at stake. Today's Japan was invented by a collective act of will following the devastation of World War II. It was successful because it had the flexibility to apply its unique strengths to the best ideas then available-regardless of where those ideas came from. It is time for Japan to reinvent itself once more, based on a deeper understanding of the strengths and limitations of its approach and a new, more sophisticated way of competing

[Author note]

MICHAEL E. PORTER is C. Roland Christensen Professor of Business Administration at the Harvard University Graduate School of Business. HIROTAKA TAKEUCHI is Dean of the Hitotsubashi University Graduate School of International Corporate Strategy. Mariko Sakakibara, co-author of the book-length version of this article, Lucia Marshall, and Yoshinori Fujikawa provided valuable assistance. This article draws on M. E. Porter, The Competitive Advantage of Nations, and "Clusters and Competition: New Agendas for Companies, Government, and Institutions," in On Competition.